

DISCUSSION TOPICS

FRANCHISE TAX BOARD INTERESTED PARTIES MEETING – SALES FACTOR; SALES OF TANGIBLE PERSONAL PROPERTY; REGULATION SECTION 25106.5 OCTOBER 4, 2011

1. BACKGROUND

Revenue & Taxation Code (RTC) section 25135 provides the sales factor numerator assignment rules for sales of tangible personal property. During 2009, the Legislature amended RTC section 25135, operative for taxable years beginning on or after January 1, 2011. As amended, RTC section 25135 requires that sales of tangible personal property delivered or shipped to a purchaser in California be assigned to California if the seller or any member of the seller's combined reporting group is taxable in California. In addition, all sales of tangible personal property delivered to a state other than California are not assigned (thrown back) to California if any member of the seller's combined reporting group is taxable in that state.

The first interested parties meeting was held on May 26, 2011 and a [summary](#) of that meeting was posted on the Franchise Tax Board website. Public input regarding possible regulatory language was elicited at the first interested parties meeting. During the first interested parties meeting, an attendee suggested that the Hearing Officer draft proposed language to amend the existing California Code of Regulations, title 18 (Regulation), section 25106.5 based on a prior discussion draft the FTB prepared but did not adopt during the 2000 regulation amendment. This second interested parties meeting is for the purpose of discussing this [proposed language](#).

The proposed language is modeled after the language contained in Regulation section 25137-14 as well as language discussed at the time the original Regulation section 25106.5 was promulgated.

The proposed language adds a new subsection (c)(7)(A) to implement the 2009 legislative change to RTC section 25135. For taxable years beginning on or after January 1, 2011, the new subsection (c)(7)(A) sets forth the method for calculating the California source combined report business income of the taxpayer member in a combined reporting group. The first step is to determine the combined reporting group's California apportionment percentage to arrive at the group's California source combined report business income. The second step is to determine each taxpayer member's intrastate apportionment percentage to arrive at the respective taxpayer member's California source combined report business income.

Examples based on FTB Notice 90-3 are provided to illustrate the calculation method. In addition, the proposed language adds three definitions to the existing Regulation section 25106.5(b) for terms of art utilized in the new method.

The proposed amendments maintain the *Joyce* rule within a new subsection (c)(7)(B) for taxable years beginning on or after April 22, 1999 and before January 1, 2011.

2. STAFF'S EXPECTATIONS FOR THE MEETING

Staff seeks to allow the public an opportunity to share ideas on the content of possible amendments to Regulation section 25106.5. Staff believes that the following core principles provide an objective basis upon which to evaluate any proposed changes to the existing Regulation section 25106.5. Among these principles are:

- (1) Equity: Are all similarly situated taxpayers being treated in a similar manner?
- (2) Administration: Is a rule as clear and simple as possible? Can taxpayers and the FTB apply a rule?
- (3) Elimination of potential disputes: Does a rule raise new concerns that could lead to new disputes?
- (4) Recordkeeping: Does a rule use existing records as much as possible to minimize the burdens of recordkeeping on taxpayers?